

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 EB-07 FRB-03 INR-07

NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01

LAB-04 SIL-01 OMB-01 PM-04 NSC-05 SS-15 DODE-00 PA-01

PRS-01 AGR-05 AGRE-00 AF-08 EA-07 /101 W

----- 122790

R 211522Z SEP 76

FM AMEMBASSY MOSCOW

TO SECSTATE WASHDC 8952

INFO AMEMBASSY BELGRADE

USMISSION BERLIN

AMEMBASSY BERLIN UNN

AMEMBASSY BUCHAREST

AMEMBASSY BUDAPEST

USMISSION NATO

AMEMBASSY PRAGUE

AMEMBASSY SOFIA

USDOC WASHDC

AMEMBASSY WARSAW

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USDOC FOR BEWT (DOWNEY)

E.O. 11652: GDS

TAGS: EEWT, EFIN, ECON, ETRD, UR, US

SUBJECT: SOVIET INDEBTEDNESS AND US-SOVIET TRADE PROSPECTS

SUMMARY: FOLLOWING REPORT BASED ON IMPRESSIONISTIC INCOMPLETE ROUND  
OF DISCUSSIONS WITH SOVIET TRADE AND ECONOMIC OFFICIALS, U.S. AND  
FOREIGN BUSINESSMEN AND FOREIGN DIPLOMATS, AS WELL AS REVIEW  
OF ECONOMIC PRESS IN RECENT WEEKS. IT IS OUR CONCLUSION THAT  
WHILE TRADE STATISTICS SHOW A RESPECTABLE FLOW OF U.S. NON-AGRI-  
CULTURAL EXPORTS TO THE USSR IN THE FIRST HALF OF 1976, THERE ARE  
SOME SIGNS THAT NEW BUSINESS HAS RECENTLY BEEN AT LEAST TEMPORARILY  
HARDER TO DEVELOP AS A RESULT OF CURRENT SOVIET HARD CURRENCY  
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SHORTAGE. IT IS TOO SOON TO SAY IF THIS APPARENT RECENT TREND

WILL CONTINUE OR BE REVERSED. SOVIET CONCERN ABOUT IMPLICATIONS OF INDEBTEDNESS AND NEGATIVE HARD CURRENCY TRADE BALANCE PLACES ADDED EMPHASIS ON CREDIT TERMS AND COMPENSATION AGREEMENTS, ABOUT WHICH GERMANS AND PERHAPS OTHER WESTERN COMPETITORS HAVE BEEN MORE FLEXIBLE AND/OR BETTER SITED THAN US FIRMS TO PROVIDE. THIS IS PARTIALLY COUNTERBALANCED BY STATED SOVIET EMPHASIS ON PRODUCT QUALITY. THIS SHOULD FREQUENTLY FAVOR US OVER FOREIGN COMPETITORS, AND THERE IS ALSO EVIDENCE THAT THIS IS OCCURRING. SOVIET CONTENTION THAT US DISCRIMINATORY TRADE AND CREDIT POLICY COSTS US EXPORTS AND JOBS IS RECOGNIZED BY MOST BUSINESSMEN WITH WHOM WE HAVE SPOKEN AS POLITICAL PLOY. NEVERTHELESS MANY BELIEVE THAT ABSENCE OF GOVERNMENT-BACKED CREDIT DOES INFLUENCE SOVIET DECISION WHERE OTHER FACTORS ARE ROUGHLY EQUAL; OTHER POINT OUT THAT ABSENCE OF MFN HANDICAPS US FIRMS WHICH WOULD OTHERWISE BE ABLE TO ACCEPT BARTER COMPENSATION FOR EXPORTS. END SUMMARY.

1. IMPLICATION OF GROWING SOVIET INDEBTEDNESS TO ADVANCED WESTERN COUNTRIES FOR THE IMMEDIATE FUTURE OF US BUSINESS HERE ARE STILL DIFFICULT TO FORECAST. ON THE ONE HAND, TRADE STATISTICS SHOW A SUBSTANTIAL INCREASE IN NON-AGRICULTURAL US EXPORTS IN THE FIRST HALF OF 1976 AND THERE IS FAVORABLE EVIDENCE IN THE FORM OF SIGNED CONTRACTS (E.G., PEPSICO, HONEYWELL, INTERNATIONAL HARVESTER) AND RENEGOTIATION OF BUSINESS THOUGHT LOST TO OTHERS (E.G., SPERRY-UNIVAC AIR CONTROL SYSTEM). A NEW MOSCOW HOTEL AND THE NEW MOSCOW AIRPORT TERMINAL MAY GO TO TOWER INTERNATIONAL AND A BHA CONSORTIUM, RESPECTIVELY. SOME FIRMS SEE SIGNS THAT THE USSR MAY BE INCREASINGLY OPEN TO PROPOSALS FOR JOINT VENTURES INVOLVING A SUBSTANTIAL DEGREE OF US RESPONSIBILITY FOR QUALITY CONTROL (E.G., BENDIX INTERNATIONAL NEGOTIATIONS ON SPARKPLUG PRODUCTION). ON THE OTHER HAND, A NUMBER OF BUSINESSES LOCATED HERE REPORT RECENT SETBACKS. THE LOCAL IBM REPRESENTATIVE REPORTS THAT DIM BUSINESS PROSPECTS HAVE CAUSED A SHARP CUT IN HIS SUPPORT STAFF (ADMITTEDLY ONE OR TWO ADDITIONAL COMPUTER SALES- BEYOND THE ONE TO INTOURIST - COULD ALTER THIS PICTURE); CATERPILLAR REP NOTING THAT SALES OF MACHINERY AND TRANSPORT EQUIPMENT HAS FIGURED HEAVILY IN US EXPORTS TO USSR TO PRESENT, TOLD E/C COUNSELOR THAT HE HAS NO NEW BUSINESS AT ALL IN THE OFFING. HEWLETT-PACKARD REPRESENTATIVE HAD A SIMILAR REPORT. CONFIDENTIAL

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THE LOCAL GENERAL ELECTRIC REPRESENTATIVE IS UNHAPPY OVER THE LOSS OF MOST OF LUCRATIVE ORENBURG COMPRESSOR STATION BUSINESS TO FOREIGN COMPETITORS, BUT HE ASCRIBES THIS TO GE'S UNWILLINGNESS TO CUT ITS OFFERING PRICE TO MEET SOVIET TERMS. ABBOT LABORATORIES HAS REPORTED THE PROBABLE LOSS OF \$33 MILLION BABY FORMULA CONTRACT, FROM WHICH SOVIETS DREW BACK AT LAST MINUTE. DOW CHEMICALS ALSO HAS HAD DECLINE IN 1976 SALES TO USSR, ATTRIBUTABLE IN PART TO SOVIET CONCERNS ABOUT INDEBT-

EDNESS. ENGELHARD CHEMICALS HAS MENTIONED THAT LACK OF MFN FOR SOVIET EXPORTS HURTS TWO-WAY TRADE, SINCE SOVIET COMPENSATION PRODUCTS MUST BE DISCOUNTED FOR SALE ON US MARKET. WHILE OUR SELECTIVE SAMPLE IS NOT SUFFICIENT TO MAKE ANY FORECASTS, IT DOES APPEAR TO CALL ATTENTION TO POSSIBILITY OF A FUTURE DOWNTURN IN NON-AGRICULTURAL EXPORTS.

2. SOVIET OFFICIALS HAVE MADE POINT OF STRESSING THAT USSR IS DIVERTING BUSINESS - AT COST OF US PROFITS AND JOBS - FROM US TO OTHER ADVANCED WESTERN COUNTRIES WHICH OFFER FAVORABLE CREDIT TERMS AND DO NOT DISCRIMINATE AGAINST SOVIET EXPORTS. THEY HAVE WARNED SOMEWHAT OMINOUSLY THAT US-SOVIET RELATIONS MAY NOT YET HAVE "HIT BOTTOM." THEY MAKE SAME POINT ABOUT LOST CONTRACTS TO US BUSINESSMEN. CHAIRMAN KENDALL OF PEPSICO GAVE THIS THESIS FURTHER CURRENCY IN PUBLIC REMARKS AT RECENT CONTRACT SIGNING (MOSCOW 13087). RESIDENT PULLMAN REP COMPALINED TO COMATT A FEW WEEKS AGO THAT 1974 TRADE ACT PROVISIONS DENYING MFN AND CREDITS TO SOVIETS HAD "REALLY HURT" HIS FIRM'S PROSPECTS IN USSR - SO MUCH SO THAT ANY LENGTHY STRETCHOUT OF CURRENTLY BLEAK OUTLOOK MAY CAUSE PULLMAN TO REASSESS VALUE OFKEEPING OPEN ITS OFFICE IN MOSCOW. NEVERTHELESS MOST BUSINESSMEN WITH WHOM WE SPOKE FEEL THAT GENERAL SITUATION IS REAL ROOT CAUSE, ALTHOUGH THEY DO NOT DISCOUNT ADVERSE CONSEQUENCES OF CURRENT US POLICY FOR AMERICAN EXPORTS. MINISTRY OF FOREIGNTRADE OFFICIAL ACKNOWLEDGED PRIVATELY THAT USSR IS "CERTAINLY" ALSO TIGHTENING UP ON PURCHASES FROM OTHER WESTERN COUNTRIES AS WELL, EVEN THOUGH IT HAS STILL UNUSED LINES OF GOVERNMENT -SUBSIDIZED CREDIT AVAILABLE. WE HAVE JUST BEEN SHOWN SIX MONTH FIGURES FOR WEST GERMAN-SOVIET TRADE - BEING REPORTED SEPARATELY - WHICH SHOW FRG EXPORTS UP 5.9 PERCENT OVER THE SAME PERIOD IN 1975 BUT SOVIET EXPORTS UP 49.5 PERCENT. GERMAN ECONOMIC/COMMERCIAL MINISTER TOLD E/C COUNSELOR THAT CONTINUING GERMAN ABILITY TO

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INCREASE ALREADY SIGNIFICANT LEVEL OF EXPORTS HERE IS DUE IN PART TO GREATER WILLINGNESS OF GERMAN FIRMS TO ACCEPT COMPENSATION ARRANGEMENTS INVOLVING SOVIET RAW MATERIALS. SOME WESTERN EMBASSIES HAVE PERCEPTION OF DOWNTURN IN NEW ORDERS. BELGIAN, AUSTRIAN AND DANISH SIX MONTH TRADE STATISTICS APPEAR TO REFLECT ADVERSE TREND IN THEIR BALANCES WITH USSR. SEVERAL US BANKERS HAVE REPORTED THAT COOLING OF BUSINESS CLIMATE HAS BEEN GENERAL. AGAIN, OUR SAMPLING IS STILL TOO SMALL TO PERMIT FORECAST, BUT THESE COMMENTS DO INDICATE THAT OTHER WESTERN COUNTRIES ARE ALSO FINDING SOVIETS TO BE INCREASINGLY HARD BARGAINERS, PARTICULARLY WITH REGARD TO TEMS AND DEFERRALS OF PAYMENT

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INFO OCT-01 ISO-00 AID-05 CIAE-00 EB-07 FRB-03 INR-07

NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01

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PRS-01 AGR-05 AGRE-00 AF-08 EA-07 /101 W

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R 211522Z SEP 76

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3. SOVIET OFFICIALS ARE CHARACTERISTICALLY RELUCTANT TO DISCUSS DEBT ISSUE OR TO CONCEDE THAT THEY HAVE ANY CREDIT PROBLEMS. INCIDENTLALY, A USA/CANADA INSTITUTE SENIOR ECONOMIST IN MENTIONING VOLUME OF BUSINESS ALLEGEDLY LOST BY US FIRMS TO WESTERN COMPETITORS, RECENTLY USED FIGURE OF \$11.4 BILLION: WE TAKE THIS AS POSSIBLE SLIP OF TONGUE REPRESENTING FIGURE FOR SOVIET HARD CURRENCY DEBT NOW CURRENT IN SOVIET INTERNAL USE. (A SOVIET FOREIGN TRADE MINISTRY OFFICIAL STATED IT PUBLICALLY AT \$10 BILLION LAST MONTH). SAME ECONOMIST, AFTER POSING NUMBER OF QUESTIONS ABOUT SOUTH AFRICAN GOLD SALES POLICY, FALLING INTERNATIONAL PRICE OF GOLD, ROLE OF SPECULATORS, ETC., SAID WITH RESIGNED AIR THAT COUNTRIES

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ARE NOT ALWAYS ABLE TO CONTROL CONDITIONS IN WHICH THEY WILL SELL (GOLD), A REMARK AS EASILY APPLICABLE TO USSR AS TO SOUTH AFRICA. SOVIET TRADE OFFICIALS HAVE MADE POINT OF PRINCIPLE THAT THEY WILL NOT GO OVER 7 1/2 PERCENT INTEREST RATE IN COMMERCIAL TRANSACTIONS, BUT THERE SEEMS NO DOUBT THAT THEY ARE OBLIGED TO PAY A HIGHER EFFECTIVE RATE, WITH INCREMENT TACKED ON TO COST OF COMMODITY. UNDER THESE CIRCUMSTANCES SOVIETS ARE GIVING EVEN GREATER ATTENTION TO CREDIT TERMS AND TO POSSIBILITY OF PAYING FOR IMPORTS THROUGH COMPENSATION ARRANGEMENTS, WITH PAYMENT DEFERRED IN INTERIM. SUCH CONDITIONS IN THEMSELVES DO NOT SEEM TO AUGUR WELL FOR US EXPORTS. ON THE OTHER HAND, SOVIET PRESS IS GIVING CONSIDERABLE ATTENTION TO EMPHASIS OF QUALITY OF PRODUCTION AND REDUCTION OF PRODUCTION COSTS WHICH FIGURE SO PROMINENTLY IN DRAFT TWENTYFIVE YEAR PLAN, 1976-1980. EMPHASIS ON QUALITY OVER COST AND CREDIT TERMS SEEMS ON BALANCE TO FAVOR US FIRMS. APPARENT SOVIET DECISION TO RESUME NEGOTIATIONS WITH SPERRY-UNIVAC ON AIR TRAFFIC CONTROL SYSTEM IS ONE POSSIBLE EXAMPLE OF THIS.

4. FAVORABLE PROSPECTS FOR GRAIN HARVEST ARE DOUBTLESS GLADDENING THE HEARTS OF SOVIET TRADE OFFICIALS, AND BANKERS, AS MUCH AS THEY DO FARM OFFICIALS. IT WAS 1975 AGRICULTURAL DISASTER THAT CONTRIBUTED SO HEAVILY TO CURRENT SQUEEZE. NEVERTHELESS, EVEN A GOOD GRAIN FORECAST DOES NOT GIVE USSR PROSPECT OF FAVORABLE HARD CURRENTLY BALANCE, AND THERE IS NO ASSURANCE THAT GOLD PRICE WILL REGAIN EARLIER GIDDY LEVELS. MOREOVER, THERE MAY BE FUTURE GRAIN DISASTERS IN YEARS AHEAD. BASIC PROBLEM REMAINS TO INCREASE EXPORTS IN ORDER TO PAY FOR IMPORTS OF TECHNOLOGY FOR WHICH SOVIET ECONOMY HAS RECOGNIZED THE NEED. HENCE THE CONTINUING SOVIET INTEREST IN PROJECTS TO DEVELOP ENERGY SOURCES, PARTICULARLY THOSE IN SIBERIA, WHICH COULD PROVIDE USSR WITH MORE ASSURED LONG-TERM MEANS OF PAYMENT.

5. CONCLUSION. GIVEN THESE CONDITIONS US FIRMS WOULD SEEM WELL ADVISED TO EMPHASIZE LABOR AND COST SAVING ASPECTS OF PRODUCTS, CONSIDER SOME INNOVATIVE COMMERCIAL ARRANGEMENTS INVOLVING AT LEAST SOME BUY-BACK PROVISIONS AND TO BE READY FOR EVEN TOUGHER BARGAINING SESSIONS WITH SOVIET FOREIGN TRADERS. RESTORATION OF EX-IM FINANCING AND GRANTING OF MFN  
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WOULD, OF COURSE, STRENGTHEN CHANCES OF AMERICAN BUSINESSMEN TO COMPETE SUCCESSFULLY WITH WEST EUROPEAN AND JAPANESE FIRMS FOR SOVIET MARKET.

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## Message Attributes

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**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** ECONOMIC DEVELOPMENT, EAST WEST TRADE, DEBT REPAYMENTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 21 SEP 1976  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** GolinoFR  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
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**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** RR  
**Errors:** N/A  
**Film Number:** D760356-0936  
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**Original Handling Restrictions:** n/a  
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**Previous Channel Indicators:** n/a  
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**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** GolinoFR  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 09 APR 2004  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <09 APR 2004 by greeneet>; APPROVED <12 APR 2004 by GolinoFR>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
04 MAY 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** SOVIET INDEBTEDNESS AND US-SOVIET TRADE PROSPECTS SUMMARY: FOLLOWING REPORT BASED ON IMPRESSIONISTIC INCOMPLETE ROUND OF DISCUSSIONS WITH SOVIET TRADE AND ECONOMIC OFFICE  
**TAGS:** EEW, EF, ECON, ETRD, UR, US  
**To:** SECSTATE WASHDC BELGRADE BERLIN BERLIN BUCHAREST BUDAPEST NATO PRAGUE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006